

# **REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON GARIEP LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the accompanying financial statements of the Gariep Local Municipality, which comprise the statement of financial position as at 30 June 2011, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages ... to ....

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No.1 of 2010 as amended) (DoRA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## **Basis for qualified opinion**

### **Value-added tax (VAT)**

7. The municipality was unable to reconcile the VAT receivable of R1,1 million (2010: R1,1 million), as disclosed in the statement of financial position, to the returns submitted to the South African Revenue Services (SARS). An unexplained difference of R963 567 was identified during the audit. In addition, in contravention of section 28 of the VAT Act of South Africa, 1991 (Act No. 89 of 1991), the municipality has not submitted VAT 201 forms since January 2011. Consequently, I was not able to verify the completeness, existence and valuation of the VAT receivable disclosed on the statement of financial position. The municipality's records did not permit the application of alternative audit procedures to this balance.

### **Expenditure**

8. Included in total expenditure of R73,5 million disclosed in the statement of financial performance is R28,4 million, relating to repairs and maintenance, bulk purchases, grant and general expenses expenditure, which is overstated by R2,7 million as a result of the VAT element being incorrectly allocated to the above categories of expenditure for the year.

### **Trade and other payables from exchange transactions**

9. Included in trade payables of R41,1 million as disclosed in note 11 to the financial statements is a bank transfer suspense account (unallocated receipts) amounting to R2,4 million which could not be confirmed as sufficient appropriate supporting documentation could not be produced. As a result, the existence, accuracy and completeness of the unallocated receipts could not be confirmed. The municipality's records did not permit the application of alternative audit procedures to this balance.

### **Bank overdraft**

10. The municipality did not properly reconcile the bank balance for the year and as a result it was not possible to carry out all the required audit procedures or to obtain all the information and explanations necessary to confirm the bank overdraft amount of R7,4 million (2010: R194 439), as disclosed in note 7 to the financial statements. As a result, the completeness and valuation of the bank overdraft, as disclosed in note 7 to the financial statements, could not be confirmed. The municipality did not have adequate accounting records to permit the application of alternative audit procedures to this balance.

### **Irregular expenditure**

11. Irregular expenditure of R1,2 million relating to goods and services acquired in contravention of the supply chain management (SCM) requirements is disclosed in note 37 to the financial statements. However, the municipality does not have sufficient controls in place to ensure compliance with the SCM policy requirements and a deviation register is also not maintained. As a result it was not possible to determine the full extent of the irregular expenditure that should have been disclosed in note 37 to the financial statements.

**Fruitless and wasteful expenditure**

12. As disclosed in note 36 to the financial statements, expenditure of R186 918 in respect of goods and services could have been avoided had due care been exercised by officials when authorising payments and applying the policies and procedures of the municipality. The municipality does not maintain a register of all late payments made due to cash flow restrictions, and thus, does not distinguish between interest and penalties and payments for goods and services. As a result I could not satisfy myself that all fruitless and wasteful expenditure incurred by the municipality during the year was disclosed in note 36 to the financial statements.

**Accumulated surplus**

13. As disclosed in note 32 to the financial statements, corresponding figures have been restated by R7,2 million in order to address prior year misstatements. However, prior period adjustments amounting to R8,1 million have been recorded in the statement of changes in net assets, resulting in an unexplained difference of R923 511. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and rights pertaining to the prior year adjustments. The municipality's records did not permit the application of alternative audit procedures.

**Qualified opinion**

14. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Gariep Local Municipality as at 30 June 2011, and its financial performance and cash flows for the year then ended in accordance with GRAP and the requirements of the MFMA and DoRA.

**Emphasis of matters**

15. I draw attention to the matters below. My opinion is not modified in respect of these matters:

**Restatement of corresponding figures**

16. As disclosed in note 32 to the financial statements, the corresponding figures for 30 June 2010 have been restated as a result of errors discovered in the financial statements of Gariep Local Municipality at, and for the year ended 30 June 2011.

**Financial sustainability**

17. Note 34 to the financial statements indicates that the municipality has an accumulated deficit of R41,6 million and that the municipality's total liabilities exceed its assets by the same amount. These conditions, along with other matters as set forth in note 34, may impact on the financial sustainability of the municipality to continue its normal operations.

**Unauthorised expenditure**

18. As disclosed in note 35 to the financial statements, unauthorised expenditure amounting to R15,5 million was incurred by the municipality during the year. This was the result of the overspending of the total amount appropriated per vote for the executive: municipal manager and budget and treasury departments in the municipality's approved budget.

### **Material losses**

19. As disclosed in note 39 to the financial statements, the municipality incurred losses on the distribution of electricity amounting to R4,4 million during the year under review.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

20. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the municipality.

### **Predetermined objectives**

#### **Presentation of information**

21. The following criterion is relevant to the finding below:
- Performance against predetermined objectives is reported using the National Treasury guidelines.
22. Audit finding:

#### **Measures taken to improve performance were not provided in performance report**

23. Measures taken to improve performance were not provided in the performance report, as required in section 46(1)(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). In total, all of the indicators had no details of the measures taken to improve performance.

#### **Usefulness of information**

24. The following criteria are relevant to the findings below:
- Consistency: The reported objectives, indicators and targets are consistent with the approved integrated development plan (IDP).
  - Measurability: The indicators are well defined and verifiable, and targets are specific, measurable, and time bound.

25. Audit findings:

#### **Reported objectives, indicators and targets are not consistent when compared with the planned objectives, indicators and targets**

26. Forty-nine per cent of reported performance against predetermined objectives and 100% of reported performance against predetermined indicators and targets are not consistent with the approved IDP.

#### **Planned and reported targets are not specific, measurable and time bound**

27. For both the planned and reported targets:
- Eighty per cent were not specific in clearly identifying the nature and the required level of performance;
  - Ninety per cent were not measurable in identifying the required performance; and
  - None were time-bound in specifying the time period or deadline for delivery.

**Planned and reported measures are not verifiable**

28. For the selected service delivery objectives, valid performance management processes and systems that produce actual performance against the planned measures do not exist for 96% of the indicators.

**Planned and reported indicators are not well defined**

29. For the service delivery objectives, 86% of the planned and reported indicators were not clear, as well defined data definitions were not available to allow for data to be collected consistently.

**Compliance with laws and regulations****Strategic and performance management**

30. The municipality did not adopt and implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players as required by sections 38, 39, 40 and 41 of the MSA and regulations 7 and 8 of the Local Government Municipal Planning and Performance Management Regulations, 2001 published in *General Notice 796 of 24 August 2001* (MPPR).
31. The accounting officer of the municipality did not submit the results of the assessment on the performance of the municipality during the first half of the financial year to the mayor of the municipality, the National Treasury, and the provincial treasury as required by section 72(1)(b) of the MFMA.
32. The IDP did not include the key performance indicators and performance targets determined according to its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the MPPR.

**Annual financial statements and annual report**

33. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements were identified by the auditors. Although some misstatements were subsequently corrected, there were material misstatements that were not corrected. These uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
34. The mayor did not:
- Table, within seven months after the end of the financial year, in council, the 2009-10 annual report of the municipality, as required by section 127(2) of the MFMA.
  - Submit a written explanation to the council setting out the reasons for the delay in the tabling of the 2009-10 annual report in council on 4 February 2011, as required by section 127(3) of the MFMA.
35. The accounting officer did not:
- Make the 2009-10 annual report public immediately after the annual report was tabled in the council as required by section 127(5) of the MFMA.
  - Make public the council's oversight report on the 2009-10 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.



**Audit committee**

36. The audit committee was appointed during April 2011 and was not in place for the entire year as required by section 166 of the MFMA.
37. The late appointment of the audit committee resulted in it not fulfilling all of the duties required of it by section 166(1) of the MFMA.
38. The performance audit committee or another committee functioning as the performance audit committee did not perform the following as required by regulation 14 of the MPPR:
  - Meet at least twice during the financial year;
  - Review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality;
  - Review the municipality's performance management system and make recommendations in this regard to the council of the municipality; and
  - Submit an auditor's report to the council regarding the performance management system at least twice during the financial year.

**Internal audit**

39. The internal audit was appointed during April 2011 and was not in place for the entire year as required by section 165(1) of the MFMA.
40. The late appointment of the internal audit resulted in it not fulfilling all of the duties required of it by section 166(1) of the MFMA.
41. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes as required by section 45(1)(a) of the MSA and regulation 14 of the MPPR.

**Procurement and contract management**

42. Quotations were accepted from prospective providers who were not on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulations 16(b) and 17(b).
43. Sufficient appropriate audit evidence could not be obtained to verify that awards were made to providers whose tax matters have been declared by SARS to be in order, as required by SCM regulation 43.
44. Awards were made to suppliers who did not submit a declaration on their employment by the state or either their relationship to a person employed by the state as per the requirements of SCM regulation 13(c).
45. Awards were made to providers who are persons in service of the municipality in contravention of SCM regulation 44. Furthermore, the providers failed to declare that he/she was in the service of the municipality as required by SCM regulation 13(c).
46. Awards were made to providers who are persons in service of other state institutions in contravention of the requirements of SCM regulation 44. Furthermore, the provider failed to declare that he/she is in the service of the state as required by SCM regulation 13(c).

### **Budgets**

47. The mayor did not, within 30 days after the end of each quarter, submit all quarterly reports to the council on the implementation of the budget and the financial state of affairs of the municipality, as required by section 52(d) of the MFMA.

### **Asset management**

48. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained:
- A management, accounting and information system which accounts for the assets of the municipality as required by section 63(2)(a) of the MFMA; and
  - An effective system of internal control for assets (including an asset register), as required by section 63(2)(c) of the MFMA.

### **Expenditure management**

49. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
50. The accounting officer did not take reasonable steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
51. The municipality did not recover unauthorised, irregular or fruitless and wasteful expenditure from the liable person, as required by section 32(2) of the MFMA.

### **INTERNAL CONTROL**

52. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

53. There is a lack of oversight and accountability by senior management. Sufficient monitoring controls are not in place to ensure the proper functioning of the overall process of planning, budgeting, implementation, reporting and adherence to internal policies and procedures for the purpose of taking corrective action. Although the audit action plan was formulated and implemented it was not effective and properly monitored as audit findings on VAT, bank overdraft and payables in the prior financial year were repeated in the current financial year.
54. The municipality does not have adequate processes in place to identify and record unauthorised, irregular as well as fruitless and wasteful expenditure. There is a lack of monitoring by senior management which resulted in irregular and fruitless and wasteful expenditure identified in the year under review.

55. The municipality was not able to enforce oversight responsibility over reporting and compliance, specifically with respect to the information technology (IT) system for the whole financial year, due to the inability to appoint sufficient skilled individuals prior to March 2011. In addition, there is no formal IT governance framework for the year under review. As a result, numerous errors have been identified during the course of the audit resulting in material amendments to the financial statements submitted for audit purposes.

#### **Financial and performance management**

56. The municipality's manual and automated controls are not designed and implemented to ensure that the transactions have occurred, are authorised, and are completely and accurately processed. Management does not adequately manage transactions upon recording, which resulted in the findings under the basis for qualified opinion paragraphs, predetermined objectives and compliance with laws and regulations.
57. The municipality places a large amount of reliance on the consultants appointed for the preparation of the financial statements. However, a significant amount of material adjustments were required to be made to the financial statements submitted for audit purposes.
58. The municipality does not have adequate processes in place to obtain declarations of employment before awards are made, as per SCM requirements. This resulted in irregular expenditure identified during the year under review.
59. The municipality does not have processes in place to ensure compliance with laws and regulations and thus, the municipality has not fully complied with all the requirements of the MFMA, MSA, MPPR, SCM regulations and DoRA.
60. The municipality does not have IT security and account management policies and procedures for the IT system. In addition, there are no periodic reviews of user access to the system to ensure that it is in line with job responsibilities and to prevent possible unauthorised amendments to the system.

#### **Governance**

61. The municipality did not implement the approved and adopted fraud prevention plan and it could not be determined if a risk management plan, as required by the fraud prevention plan, was prepared, approved and implemented during the year under review. The municipality does not have a formal risk assessment process for the IT system in use at the municipality. This reduces the ability of management to effectively manage the risk of fraud and limits management's ability to appropriately address any significant deficiencies, thus increasing the number of material misstatements in the financial statements.
62. The internal audit unit and audit committee were not functional for the full financial year. Although an audit plan was prepared, not all the audits were performed as per the audit plan. The audit committee members were only appointed in April 2011 and only two meetings were held for the year under review. The limited existence and activities of the internal audit unit and audit committee for the year under review has resulted in the inability of the municipality to gain access to levels of assurance required to confirm the accuracy and credibility of information utilised by the municipality.



## OTHER REPORTS

### Investigations

63. An investigation was conducted by an independent consulting firm into suspected irregularities in the cash management and cash handling activities at the finance and traffic departments at the municipality. The investigation was completed during the 2010-11 financial year. Due to the outcome of the investigation, the contract between the municipality and the pre-paid electricity vendor was cancelled and a debtor raised for the outstanding amount.

*Auditor-General*

East London

30 November 2011



AUDITOR-GENERAL  
SOUTH AFRICA

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